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No. 253

In the Supreme Court of the United States

OCTOBER TERM, 1940

EUGENE HIGGINS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 68) is reported in 39 B. T. A. 1005. The opinion of the Circuit Court of Appeals (R. 243) is reported in 111 F. (2d) 795.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 22, 1940 (R. 245). The petition for a writ of certiorari was filed July 18, 1940, and granted October 14, 1940. The jurisdiction of this Court is conferred by Section 240 (a) of the

Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner is entitled to deduct certain expenditures made by him in 1932 and 1933 in connection with security investments as ordinary and necessary expenses paid in carrying on a trade or business within the meaning of Section 23 (a) of the Revenue Act of 1932.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations involved will be found in the Appendix, *infra,* pp. 31–33.

STATEMENT

The Board of Tax Appeals adopted the stipulation of facts entered into by the parties (R. 69, 48–67), and made certain additional findings of fact (R. 69–78) based upon the evidence introduced at the trial (R. 109–238).

The petitioner is a citizen of the United States, though he has not been in this country since 1921. He has lived in Europe, particularly in France, during that period as a matter of choice for his own pleasure and for his health. He has a sea-going yacht. He has no busines in Europe and has not reported any income from foreign corporations (R. 68–69, 74–75).

During the taxable years, 1932 and 1933, the petitioner's personal fortune was approximately $35,000,000 or $36,000,000. He owned some 30

pieces of real estate in or near New York, valued at approximately $10,000,000. The remainder of his wealth was invested in securities, more than half of which consisted of tax-exempt bonds, $16,453,000 in 1932 and $17,278,000 in 1933 (R. 70, 72). The question here presented is whether he may deduct as "business" expenses various expenditures made by him during the years 1932–1933 in connection with his securities. The Commissioner conceded that the expenses in connection with petitioner's real estate activities were deductible as "business" expenses, but contested the deductibility of the expenditures relating to petitioner's security investments. However, since the facts pertaining to the real estate and the securities are interrelated, it will be helpful to set them forth in full, even though the real estate expenses are not here involved.

In his 1932 income-tax return, the petitioner stated that his business, occupation, or profession was that of renting real estate. In his 1933 return, he listed no business or occupation. No income for either year was reported under the heading of "Income from business or profession." With the exception of one relatively small item in each year ($356.42 for 1932 and $1,250 for 1933), all income was reported under four heads: interest on bank deposits, notes, etc.; interest on tax-free covenant bonds; rents and royalties; and dividends from domestic corporations.

Petitioner's income in 1932 was over $1,000,000, of which $643,037.68 was derived from government tax-exempt bonds, and his income in 1933 was over $900,000, of which $654,791.14 similarly consisted of tax-exempt interest on government bonds (R. 55). Income from rents and royalties was $209,597.26 in 1932 and $173,622.81 in 1933 (R. 77).

In connection with his affairs, petitioner maintained an office in New York which was managed by William S. Whitehead with the aid of three assistants, namely Martin J. Dietz, Gustav Zimmerman, an accountant, and one Bessenbeck, a stenographer and clerk (R. 69–70). He also maintained an office in Paris upon the same grounds as his residence where he employed one D. P. Cousteau, who would attend to petitioner's correspondence and "check off" the accounts sent by the New York office (R. 70, 76).

In his New York office, the petitioner maintained an organization known as a board of control, which board during the taxable years here involved consisted of Whitehead, Zimmerman, and Marshall Stearns, who was an attorney and the petitioner's personal counsel (R. 70). The board of control devoted itself exclusively to the management of petitioner's real estate; it had nothing to do with his securities (R. 71). It met twice a week, and kept minutes of its meetings, which were sent to petitioner. At such meetings it considered propositions for new tenants and its discussions were limited to real estate matters. The board investi-

gated prospective tenants, arranged for leases, etc. In each case, however, petitioner's approval was required, and he kept in touch with his New York office almost daily. For the past 10 or 15 years, the petitioner has had a policy of not selling any real estate, the last sale occurring in 1927 (71–72).

The principal activity of the New York office was the management of petitioner's real estate (R. 75). However, a certain amount of its activities related to petitioner's securities. It kept records of his securities, and deposited his interest and dividend checks with the National City Bank or the United States Trust Company where he had accounts upon which he alone had authority to draw. He maintained a third account at the Chase National Bank to meet office salaries and expenses, upon which Stearns and Whitehead had authority to draw (R. 73–74). The office prepared and sent to petitioner a weekly statement of receipts and disbursements. It also submitted to him an annual report which took about two weeks to prepare and one week to typewrite (R. 72). Both the annual and weekly reports dealt with real estate as well as securities (R. 72, 75).

Petitioner kept his securities in two boxes, to one of which he alone had access, and to the other of which Whitehead and Stearns had access (R. 72).

Petitioner did not use his office to purchase any securities. His securities were purchased for him by the United States Trust Company (R. 72). In

his directions to that company he often stressed the requirement that investments must be entirely safe, and more than half of his securities in 1932 and 1933 were tax exempt. In 1932 the only securities purchased consisted of Massachusetts and New York state bonds and Boston municipal bonds in the aggregate amount of $675,000 (R. 72–73). In 1933 the only securities purchased were United States Government bonds in the aggregate amount of $1,052,000.[1] No one in petitioner's office made any recommendations or had anything to do with the purchase of such securities except to receive them from the United States Trust Co., to check them off with the United States Trust Co. list, and to place them in the safe deposit vault. And the activities of the office thereafter with respect to the securities were limited to receiving and depositing interest, etc., and making the usual periodic reports (R. 72, 73).

Duplicates of the records kept in the New York office were, during the taxable years, kept in France. These consisted of a cash book, registry of dividends and interest, and account books as to real estate. On two different occasions a duplicate set of the books of the New York office was sent to the petitioner in Paris. In the taxable years the extent of the petitioner's activities in the corporate

[1] Apparently the 1932 purchases were made in not more than 22 transactions and the 1933 purchases in not more than 15 (R. 146).

enterprises in which his money was invested was to receive reports and keep track of the dividends and interest he received as an investor in the stock. The stock in the various corporations owned by the petitioner was in his name, and he did not appoint anyone to vote for him (R. 76–77).

During the years 1932 and 1933 the taxpayer expended $76,498.37 and $74,502.26 respectively in connection with the maintenance of his offices, and sought deductions on account of those amounts as "business" expenses (R. 49, 52, 69). Those amounts are itemized in the record at pp. 50–54. In the Board of Tax Appeals, the Commissioner conceded that the real estate activities of the taxpayer constituted a trade or business, so that such portions of the foregoing amounts as were attributable to the real estate activities were conceded to be deductible (R. 79). However, the Commissioner contended and the Board determined that to the extent that the expenditures related to the securities they did not constitute "business" expenses within the meaning of the statute. Accordingly, where any of the items related entirely to the real estate the Board allowed deductions in full; where any of the items related entirely to the securities or were otherwise personal in nature deductions were denied in full; and finally where the items related inextricably to both real estate and securities, the Board determined that two-thirds thereof were allocable to real estate and thus deductible, leaving

one-third to be ascribed to the securities for whic deductions were denied [2] (R. 85–86).

The Circuit Court of Appeals affirmed, holdin that in caring for his investments in securities pet tioner was not "carrying on any trade or business within the meaning of Section 23 (a) of the Reve nue Act of 1932.

SUMMARY OF ARGUMENT

The petitioner seeks to deduct expenses of hi offices maintained in New York and Paris as ordi nary and necessary business expenses incurred i "carrying on" a "trade or business" within th meaning of Section 23 (a) of the Revenue Ac of 1932. The Commissioner did not contest th petitioner's right to a deduction for that portion o the expenses for 1932 and 1933 as was allocable t the petitioner's real estate activities, but contende that the portion of the expenses attributable to th security investments should be disallowed upon th ground that that portion was not incurred in carry ing on a trade or business. The only question her is whether the petitioner was engaged in carryin on a trade or business in looking after his securit investments.

The petitioner does not contend that he was a trader or speculator, and the record clearly show that he was not. He made no sales of securitie

[2] A more complete description of the various items and th facts upon which the various allocations were made appea in the record at pp. 50–54, 75–76, 77–78.

in either taxable year and derived his income from interest, rents, and dividends. The only securities purchased in either year consisted of state, municipal, and United States bonds. Since he was not a trader, the cases holding that a trader is engaged in a trade or business are not in point. The petitioner concedes that he was not engaged in any managerial activities in connection with any of the corporate enterprises in which he had investments, and hence that cases holding that such investors are engaged in a trade or business, whether correctly or incorrectly decided, are also not pertinent.

The petitioner's contention that he was engaged in a trade or business necessarily rests solely upon the fact that he was a man of great wealth and that the volume of his securities meant that collecting, recording, and investing the income from them occupied his own attention and that of his employees or agents. But these facts do not distinguish the case from that of any other investor incurring expenses in handling his investments, and the expenses incurred are personal expenses which the petitioner is prohibited from deducting by Section 24 (a).

The petitioner's argument that the management of his real estate and securities constituted a single business, and that there was no justification for apportioning the expenses between the several activities, is unsound. Only business expenses are allowable as deductions, and a personal expense is not

converted into a business expense by a taxpayer's failure to earmark the disbursements. He may not blend personal with business expenses for the purpose of obtaining a deduction which the statute otherwise denies to him.

The contention is made by the petitioner that trust companies frequently handle securities for the owner and that in so doing the trust company is engaged in business. From this premise the petitioner argues that if the owner handles his own securities, he must likewise be engaged in business. The petitioner's conclusion does not follow from his premise. When a trust company handles securities for the owner, its business consists of selling its services. When an owner handles his own securities, there is no selling of services. Performance by a taxpayer of services for himself does not constitute a business.

There has been no long-continued, consistent administrative practice supporting the petitioner's position which has received the implied approval of Congress. None of the regulations issued since 1918 in relation to the income tax contains a definition of the phrase "carrying on any trade or business," and the two informal rulings issued prior to the taxable years referred to by the petitioner have been discredited by later court decisions. The lower tribunals have not been consistent in stating the rule to be followed or in applying the rule, and the amount of litigation of itself indicates absence of settled administrative practice.

ARGUMENT

THE PETITIONER'S ACTIVITIES IN CONNECTION WITH HIS SECURITY INVESTMENTS DID NOT CONSTITUTE THE CARRYING ON OF A TRADE OR BUSINESS, AND THE EXPENSES INCURRED IN CONNECTION WITH THOSE INVESTMENTS ARE NOT DEDUCTIBLE UNDER SECTION 23 (A) OF THE REVENUE ACT OF 1932

1. *Introductory.* During the taxable years 1932 and 1933 the petitioner owned real estate in New York City valued at approximately $10,000,000, and in addition owned securities of a value between $25,000,000 and $26,000,000, of which in excess of $16,000,000 in 1932 and $17,000,000 in 1933 were nontaxable. In those years, and for many years prior thereto, the petitioner maintained an office in New York, where he employed four persons, and an office in Paris, where he employed one person. The entire time of these persons was devoted to the petitioner's affairs. He seeks to deduct the expenses of these offices as ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of Section 23 (a) of the Revenue Act of 1932, *infra*, p. 31.

No question has been raised by the Commissioner as to the propriety of the deduction of that portion of the expenses properly allocable to the petitioner's real estate investments, but the Commissioner contends that the portion of the expenses attributable to security investments should not be allowed as a deduction upon the ground that the activities in connection with those investments did not constitute the carrying on of a trade or busi-

ness within the meaning of Section 23 (a). The decision of the Board sustaining the Commissioner was affirmed by the court below, and the sole question before this Court is whether the conclusion below upon this point is correct.

The petitioner makes no contention that he was engaged in business as a trader or speculator, and it is obvious that no such contention can be made. All of the income reported in his returns for 1932 and 1933 consisted of interest on bonds and bank deposits, rents and royalties, and dividends on stock, except that for the first year he reported a small amount received in settlement of an agreement to cancel a lease, and, in the second year, a small item representing a judgment collected (R. 56, 60). His returns show no gains or losses from the sales of securities (R. 56, 60), and the record does not indicate that he maintained any brokerage accounts. The Board found that his securities were purchased for him by the United States Trust Company of New York, and that the only securities purchased in 1932 and 1933 consisted of City of Boston bonds, State of Massachusetts bonds, State of New York bonds, and United States bonds.[2]

At the very outset it is necessary to distinguish two lines of cases which, although raising superfi-

[2] The record does indicate that there was one change in his investments in 1932 for the reason that the Lackawanna Securities Company was liquidated in that year and the petitioner received bonds of the Glen Alden Coal Company in exchange for his stock (R. 19–20).

cially similar issues, are nevertheless entirely different and should be put aside in order to forestall any confusion.

First, in view of the fact that the petitioner was not a trader or speculator in securities, cases holding or assuming that a trader or speculator is engaged in business are not in point. See *Bedell* v. *Commissioner*, 30 F. (2d) 622, 624 (C. C. A. 2d); *Dart* v. *Commissioner*, 74 F. (2d) 845 (C. C. A. 4th); *Sacks* v. *Commissioner*, 66 F. (2d) 308 (C. C. A. 4th). See also *Helvering* v. *Winmill*, 305 U. S. 79; *Alverson* v. *Commissioner*, 35 B. T. A. 482.

Second, since petitioner concedes that he was not engaged in any managerial or other activities in connection with any of the corporate enterprises in which he had investments (Br. 10), cases holding that such investors are engaged in a trade or business are likewise not relevant. Cf. *Foss* v. *Commissioner*, 75 F. (2d) 326 (C. C. A. 1st); *Washburn* v. *Commissioner*, 51 F. (2d) 949 (C. C. A. 8th). While we question whether those decisions are correct insofar as they hold that an individual's participation in the management of the business of a corporation in which he owns stock has a bearing on the question whether such a person is engaged in a trade or business in connection with his security investments (see *Burnet* v. *Clark*, 287 U. S. 410; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415), it is not necessary to consider those cases here.

2. The petitioner's contention that he was engaged in a trade or business rests soley upon the fact that he was a man of great wealth, and that the volume of his securities meant that collecting, recording, and investing the income from them occupied his own attention and that of those whose services he engaged to help him.

In each of the years 1932 and 1933, the petitioner had a gross income of approximately one million dollars, over six hundred thousand dollars of which in each year was derived from tax-exempt bonds. In those years the petitioner made no sales of either securities or of real estate, and his only purchases were of nontaxable securities in a relatively small number of blocks, apparently out of accumulated income. No one in the New York office had anything to do with the purchase of securities except to receive them from the United States Trust Company and to place them in a safe-deposit vault. And the duty of the office thereafter was limited simply to receiving and depositing income therefrom, and to keeping records and making periodic reports to petitioner. Duplicate sets of books were kept in the New York office and the Paris office. Each week the petitioner was furnished a statement of receipts and disbursements; and an annual report, requiring rather extensive preparation, was likewise submitted to the petitioner by his New York office. But it is plain that such reports were only for the personal convenience of petitioner,

and their preparation no more constituted "business" activity that the keeping of less extensive records by persons of moderate means which undoubtedly does not constitute the carrying on of a trade or business.

We submit that the mere volume of his holdings does not distinguish the petitioner from any other investor, or entitle him to claim deductions for expenses that would not be allowed to a small investor.

Nearly everyone who has inherited or accumulated any capital devotes some time and energy to the conservation and enhancement of that capital, to a consideration of the character of his investment, and to the maintenance of records with respect thereto. The busy lawyer or surgeon may often find it necessary to take time out for this purpose or to engage the services of someone to do it for him. In the normal case such investment activity is not regarded as the conduct of a trade or business, and expenses incurred in connection with such activity are not deductible as business expenses. *Kane* v. *Commissioner,* 100 F. (2d) 382 (C. C. A. 2d); *Monell* v. *Helvering,* 70 F. (2d) 631 (C. C. A. 2d); *Bedell* v. *Commissioner,* 30 F. (2d) 622 (C. C. A. 2d); *Wegeforth* v. *Commissioner,* 42 B. T. A. 633. Cf. *Rogers* v. *United States,* 41 F. (2d) 865 (C. Cls.); *Miller* v. *Commissioner,* 102 F. (2d) 476 (C. C. A. 9th); *White* v. *Commissioner* (C. C. A. 3d), decided October 9, 1940, not yet offi-

cially reported, but may be found in 1940 Prentice Hall, Vol. 4, Par. 62904; *Van Wart* v. *Commissioner*, 295 U. S. 112; *Hutchings* v. *Burnet*, 58 F. (2d) 514 (App. D. C.); *Lindley* v. *Commissioner*, 63 F. (2d) 807 (C. C. A. 2d); but cf. *Kales* v. *Commissioner*, 101 F. (2d) 35 (C. C. A. 6th). Such investment expenses are personal expenditures, the deduction of which is specifically prohibited by the Revenue Act. See Section 24 (a), *infra*, p. 32.

The activities of the taxpayer here involved are precisely of the same character as those of the lawyer or surgeon in the case supposed. The difference is solely one of degree. A man of great wealth will naturally spend more time in looking after his affairs, or incur greater expense in having them looked after, than will the man of smaller means. But in proportion to the income derived, the burden in both cases is probably the same, and it seems impossible to believe that Congress intended to discriminate against persons of moderate means in favor of the owners of great wealth. Indeed, the basic philosophy underlying the graduated income tax forbids any such discrimination, and it should not be presumed that Congress so intended in the absence of any unambiguous declaration to that effect. There is nothing in the statute which suggests such a discrimination. And if Congress had intended that taxpayers should be permitted to deduct expenses incurred in transactions entered into for profit, though not

connected with a trade or business, it would have specifically so provided, as it has done with reference to losses thus incurred. See Section 23 (e), Revenue Act of 1932, *infra*, p. 31. It is our position that mere personal investment activities never constitute carrying on a trade or business, no matter how much of one's time or of one's employee's time they may occupy. Statutes granting deductions are not to be extended by construction but should be strictly construed, and the taxpayer claiming the benefit of a deduction must come squarely within its terms. *Deputy* v. *duPont*, 308 U. S. 488; *New Colonial Co.* v. *Helvering*, 292 U. S. 435; *White* v. *United States*, 305 U. S. 281; *Helvering* v. *Ind. Life Ins. Co.*, 292 U. S. 371; *Welch* v. *Helvering*, 290 U. S. 111; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319. To hold that a taxpayer deriving income from his investments otherwise than as a trader or dealer is engaged in a trade or business is to extend the meaning of Section 23 (a) beyond the natural import of the language employed.

3. Moreover, a person is generally not considered as being engaged in "carrying on" a "trade or business" unless he has dealings with other people. For example, one who writes books and puts them in a warehouse instead of selling them is not occupied in trade or business. *Chaloner* v. *Helvering*, 69 F. (2d) 571 (App. D. C.). And a person who operates a farm and utilizes the products of his

endeavor himself is not engaged in business, even though the farm provides all of the necessaries of life. *Union Trust Co.* v. *Commissioner,* 54 F. (2d) 199 (C. C. A. 6th).

As two members of this Court stated in *Deputy* v. *duPont,* 308 U. S. 488, 499, carrying on a trade or business normally involves holding one's self out to others as engaged in the selling of goods or services. In the present case the petitioner has not held himself out to others as engaged in the selling of securities. Indeed, during the two taxable years involved not a single sale of securities was made by the petitioner. But even if the petitioner had been more active in changing his investments, he still would not be engaged in trade or business if these activities related merely to conserving, enhancing, and generally caring for his estate. Although the line may perhaps be difficult to draw in a close case, the principles are clear and were suggested at least some twelve years ago by Judge Learned Hand in *Bedell* v. *Commissioner,* 30 F. (2d) 622 (C. C. A. 2d). There the taxpayer, a retail clothing merchant, had testified that he spent nearly one-half of his time buying and selling real estate and negotiable securities for profit; that he bought and sold stocks and bonds through six or seven brokers' offices where he spent about three hours a day three or four days a week, and in one of which he had a private room in conjunction with several other persons. There appeared to be some conflict on that

evidence, but Judge Hand said that even if it were accepted at face it would still not prove that the taxpayer was thus engaged in carrying on a trade or business (p. 624);

> In the first place, we are by no means satisfied, even if we were bound by his oral testimony, that it proved him to have been regularly carrying on a "business" of any kind. A trader on an exchange, who makes a living in buying and selling securities or commodities, may be said to carry on a "business"; a person who frequents brokers' offices, and continually dabbles in real estate is conceivably quite different. Most men who have capital change their investments, and may speculate all the time; we should hardly call this a business, though the line is undoubtedly hard to draw. * * *

4. But the petitioner herein was far less active in his security dealings. His purchases, although large in amount, were narrowly limited to a small number of blocks of government bonds that were plainly intended only for investment purposes. In 1932 his purchases were restricted to bonds issued by the states of Massachusetts and New York and by the City of Boston; in 1933 he bought only United States Government bonds; and during both those years he did not make any sales of securities whatever. The petitioner therefore cannot be said to have been continuously engaged in buying and selling securities or in changing his investments, and he himself concedes (Br. 48–49) that isolated,

occasional transactions do not constitute engaging in business. Carrying on a business, in the very least, connotes activity, and the question whether one is so engaged must be judged by an objective standard. Devotion of thought and study to the security market which is not translated into action is obviously not the conduct of a business. Keeping of records of one's affairs, while it may be an incident of business, does not of itself constitute a business. The petitioner's argument that he was engaged in a trade or business because of the amount of time and attention devoted to his affairs is, we submit, therefore, without merit.

Accordingly, even if mere buying and selling for investment purposes when carried on with sufficient activity could constitute a trade or business—which we deny—the very limited activities of petitioner herein could not qualify as such. The record shows very little about his securities except (1) that he rarely if ever sold any of them and that his purchases were in large blocks intended for investment; (2) that over sixty percent of his securities held in 1932 and 1933 consisted of nontaxable bonds (R. 70, 72); (3) that in buying bonds he preferred long-term, registered bonds (R. 75); and (4) that he owned some railroad and other stocks in an undisclosed amount (R. 19–20, 159). The fact that he made no sales in either year suggests that his stocks were not highly speculative in character. His securities were purchased for him

by his New York bank, and his New York office made collections of his income and kept a record of his investments. It is true that he was in touch with his New York office daily, by letter or cable, but that office also handled his real estate matters, which constituted its principal activity (R. 72). The record does not disclose that the petitioner was continuously, regularly, and actively engaged with his securities, or that he was doing anything more than any other prudent investor would do. His activity and the activities of his employees in this regard, so far as this record reveals, was limited to a relatively few purchases of government bonds, to collecting interest and dividends, and to maintaining records and preparing reports for petitioner's convenience. Thus, even under the test urged by petitioner, he was not, we submit, carrying on a trade or business with respect to his securities.

5. The petitioner relies primarily upon the definition of "business" adopted by this Court in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 171, as "That which occupies the time, attention and labor of men for the purpose of a livelihood or profit." But the total lack of relevance of that statement to the situation here presented will readily become apparent when that case is viewed in its proper setting. *Flint* v. *Stone Tracy Co.* arose under the corporation tax law of 1909 which had been enacted some three and one-half years prior to the adoption of

the Sixteenth Amendment. The statute had been enacted in belated response to the unpopular reception of this Court's decision in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601, and represented an attempt to circumvent that decision prior to constitutional amendment. The tax was imposed only upon corporate income, and the formula for avoiding the lethal consequences of the *Pollock* decision was that it was an "excise" with respect to the carrying on of business by corporations. Obviously, the purpose of Congress was to subject to tax all corporate income as far as possible in the absence of the Sixteenth Amendment; and this Court's definition of "business" in *Flint* v. *Stone Tracy Co.* was undoubtedly framed in recognition of that sweeping objective.

The question in the instant case, on the other hand, does not present any such considerations. Here, all income is subject to tax under the statute, and the only question presented is the extent to which deductions are allowable from taxable income. Congress has spelled out numerous categories of deductions. In the case of some of them, such as losses arising out of fire, storm, shipwreck, or other casualty, or from theft, the loss is deductible in full regardless of whether it is connected with the taxpayer's business and regardless of whether the property had been acquired in a transaction entered into for profit. (Section 23 (e) (3) of the Revenue Act of 1932.) Again, deductions

are allowed generally with respect to losses incurred in a transaction entered into for profit though not connected with trade or business. (Section 23 (e) (2) of the Revenue Act of 1932.) But here the deduction, if any, is permitted only under Section 23 (a) which specifically requires that the expense in question must have been paid or incurred "in carrying on any trade or business."

It is plain, therefore, that the definition of "business" in *Flint* v. *Stone Tracy Co.*, when viewed against the background of the statute there under consideration can hardly have any relevance in this case. But even if it should be thought to have any bearing here, it should be read in connection with the later decision in *McCoach* v. *Minehill & S. H. Ry. Co.*, 228 U. S. 295,[4] where it was held that the mere receipt by a lessor railroad company of the income from its leased railway property, and the receipt of interest and dividends from invested funds, bank balances, and the like, and the payment of organization and administration expenses incidental to the receipt of such moneys and their distribution among the stockholders, do not constitute such a business as was taxable under the corporation tax law of 1909.

6. The petitioner argues (Br. 37–39, 52–55) that the management of his real estate and securities

[4] See also *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *United States* v. *Emery*, 237 U. S. 28; *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187.

constituted a single "business," and that there was no justification for dividing the expenses of the New York and Paris offices between the real estate and the securities. There seems to be little merit to this contention. If the expense incurred in connection with the petitioner's securities was not a business expense, there is no basis for allowing the deduction under the statute. A personal expense cannot be converted into a business expense by a taxpayer's failure to separate the personal from the business. Indeed, there were certain disbursements by the New York office for concededly personal matters of the petitioner for which the Board disallowed deductions, and the petitioner makes no point of that disallowance (R. 85).

7. The further contention is made by the petitioner that (Br. 50–51) "The handling of a vast amount of securities, watching whether the income is promptly paid, collecting and accounting for principal and income * * * is a recognized form of business, conducted frequently by Trust Companies and Banks" for which "they make well known charges." From this premise, he argues that if those same things are done by the owner of the securities, the owner is engaged in a business. The conclusion, we submit, does not follow.

Thus, a valet is concededly engaged in a trade or business; yet his services to his employer are unquestionably personal from his employer's point of view, and his wages are plainly not deductible by

the employer as expenses incurred in the conduct of a trade or business. Similarly, when a trust company or bank handles securities for the owner, its business consists of selling its services. When an owner handles his own securities there is no selling of services, and, without more, there is no business. Again, the landscape gardener working on the petitioner's estate is engaged in a business, for he sells his services to the petitioner. If the petitioner should assist the gardener or should do the work entirely himself, it would not be for him a business but a personal activity, perhaps a pleasure. And likewise, in the present case, the petitioner's services on his own behalf did not constitute a business, nor did the payment by him to others for their services create a business.

8. The petitioner urges (Br. 57–61) that his position is supported by a long-continued administrative practice which has received the implied approval of Congress. We respectfully submit that although there have been some informal rulings which support petitioner's position, there have been in fact no regulations or Treasury Decisions in point, and that the actual practice of the Bureau of Internal Revenue has not been uniform on this issue. Accordingly, such "practice" can be of but little aid to this Court in construing the statute. Indeed, it is because of such lack of uniformity that the Treasury is now asking this Court to lay down a rule that will furnish an authoritative guide for future administration practice.

(a) None of the regulations issued since 1918 with respect to the income tax contains a definition of the phrase "carrying on any trade or business."[5] The rulings relied upon by petitioner were not promulgated by or with approval of the Secretary of the Treasury; they are not the kind of rulings that the Commissioner is directed to make by the revenue acts. Indeed, those rulings are not even signed by the Commissioner, and although they appear in the Internal Revenue Cumulative Bulletin, there is a cautionary notice in black type at the top of the front page of the bulletin to the effect that they "do not have the force and effect of Treasury Decisions". And this Court has recognized that such rulings are of little weight in interpreting the statute.[6] *Helvering* v. *N. Y. Trust Co.*, 292 U. S. 455, 467–468; *Biddle* v. *Commissioner*, 302 U. S. 573, 582; cf. *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, 52.

The petitioner cites only two rulings promulgated prior to the taxable years involved: O. D. 537, 2 Cum. Bull. 175 (1920), and O. D. 877, 4 Cum. Bull. 123 (1921).

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[5] Art. 101, Regs. 45, 62, 65, and 69; Art. 121, Regs. 75 and 77; Art. 23 (a)–1, Regs. 86, 94, and 101; Art. 19.23 (a)–1, Regs. 103. Cf. Art. 8, Regs. 41, and pp. 18–19, Regs. 33 (1918 ed.).

[6] In reaching a result substantially in conflict with that of the court below in this case, the court in *Kales* v. *Commissioner*, 101 F. (2d) 35 (C. C. A. 6th), erroneously treated the rulings involved as having the dignity of official Treasury Decisions.

O. D. 537 is to the effect that in computing the taxable net income of an estate during administration, necessary expenses, such as office rent or the compensation of a business abent, might be deductible, "the test in every case being whether the expense is an ordinary and necessary incident to the collection of income due the estate."

O. D. 877 rules that a taxpayer whose income is derived principally from investments in stocks and bonds may deduct as a business expense the rent of an office and the cost of clerical help if he can show in his return that such expense is ordinary and necessary within the meaning of the Revenue Act.

We believe that these rulings have been discredited by later decisions of the courts (see pp. 15–16, *supra*) and should therefore have little, if any, weight in determining the outcome of the present case.

(b) An argument similar to that here advanced by the petitioner with respect to the administrative practice was made in *Van Wart* v. *Commissioner*, 295 U. S. 112, and was rejected by this Court. The question in that case was whether an attorney's fee paid by a guardian for conducting litigation to secure income for his ward was a business expense and therefore deductible from the minor's gross income.

In 1925 there had been a ruling in the Treasury Department (I. T. 2124, IV–1 Cum. Bull. 138) that the fee paid an attorney for services rendered in

securing the appointment, by order of court, of a guardian capable of receiving the distributive share of a minor under a will, represents an ordinary and necessary expense incurred by the guardian in connection with the income from the property of his ward.

The Board of Tax Appeals in 1929 decided, in *Wurts-Dundas* v. *Commissioner,* 17 B. T. A. 881, that attorneys' fees paid by the guardian of the taxpayer to assert her rights to income from a trust estate constituted an ordinary and necessary business expense; and this decision was affirmed by the Circuit Court of Appeals for the Second Circuit in 1931 (54 F. (2d) 515), the court stating that where a guardian incurs reasonable and necessary expenses in securing the income to which it is entitled as guardian, it is carrying on the business of administering the ward's estate, and that the expenses of the guardian are the expenses of that business. The unreported opinion of the Board in the *Van Wart* case, *supra,* followed the decision in the *Wurts-Dundas* case. The line of reasoning in the ruling published as I. T. 2124 and in the Board's decisions in the *Wurts-Dundas* and *Van Wart* cases parallels the line of reasoning in the rulings relied upon by the petitioner here and petitioner's own argument. This Court, nevertheless, reached the conclusion in the *Van Wart* case that the Board was in error and that neither the ward nor the guardian was shown to have been engaged

in a trade or business, and the claimed deduction was therefore disallowed. Subsequently, I. T. 2124 was revoked as being in conflict with the *Van Wart* case. Mim. 4580, 1937–1 Cum. Bull., p. 62.

(c) The ruling most heavily relied upon by petitioner is I. T. 2751, XIII–1 Cumulative Bulletin 43 (1934). Not only was that ruling published after the tax years here involved, 1932 and 1933, but it was similarly an informal ruling not signed either by the Commissioner or the Secretary, and therefore, no more binding upon this Court than the rulings discussed above. Moreover, the actual administrative practice of the Bureau of Internal Revenue has not been uniform in this regard. The very number of cases cited by both sides on this issue in which the question of "trade or business" was litigated in similar situations and in which the Commissioner contested the deduction confirms the fact that the actual practice of the Treasury was not uniform either before or after 1934 with respect to this issue. Cf. *Higgins* v. *Smith*, 308 U. S. 473, 478–479.

In view of that lack of uniformity, not only of actual Treasury practice but also of the decision in the lower tribunals, the Treasury now asks this Court for an authoritative ruling to clear up the confusion. In the circumstances, it would be ironic, indeed, to resort to the doubtful informal rulings which petitioner presses upon the Court as a basis for the decision herein. Those rulings

should play no greater part here than the similar ruling in the closely analogous *Van Wart* case.

CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted.

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JANUARY 1941.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(e) *Losses By Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any tranaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty,

or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * * *

Treasury Regulations 77, promulgated under the Rev. Act of 1932:

ART. 121. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–272. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in

carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 125. *Professional expenses.*—A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently expended for books, furniture, and professional instruments and equipment, and useful life of which is short, may be deducted. As to items not deductible, see section 24 and articles 281–284.

* * * * *

ART. 281. *Personal and family expenses.*—Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives clients, patients, or callers there in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. Where the father is legally entitled to the services of his minor children, any allowances which he gives them, whether said to be in consideration of services or

otherwise, are not allowable deductions in his return of income. Alimony and an allowance paid under a separation agreement are not deductible from gross income. (See article 83.) The cost of equipment of an Army officer to the extent only that it is especially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not.

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